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ISSUES PAPER

ATTRACTING FOREIGN DIRECT INVESTMENT - APEC COULD LEAD

Attracting and retaining foreign direct investment is vital to the economic growth and development strategies of many developing nations. ACCI addressed an international conference in Melbourne recently, organised under the auspices of the APEC and the OECD, on how developing countries could pursue this objective. This article is an edited version of that speech.

Foreign direct investment is a major economic policy issue for the great majority of nations around the world.

For capital-exporting countries, core issues include defending their physical and intellectual property rights in their investments.

They do not want either the hard assets or the ideas embedded in them expropriated – either at all, or failing that, without fair and reasonable compensation.

For capital-importing countries, the objective is to attract and then retain much needed foreign direct investment in a fiercely competitive global marketplace.

For developing countries, foreign direct investment can be the engine for kick-starting and then sustaining the development engine, providing a capital platform they could not otherwise create from their domestic savings base.

And, for intermediate and somewhat more developed countries, foreign direct investment means augmenting the capital investment which the domestic economy can generate – and enhancing their technological capacities.

AUSTRALIA'S EXPERIENCE

Australia, whilst not a developing nation, seeks to attract and retain foreign direct investment for both reasons – i.e. our levels of national savings have traditionally not been sufficient to finance our investment needs, and our levels of research and development have traditionally not been sufficient to meet our technology needs.

As anyone who has looked at our published national statistics would be aware, Australia is a net importer of capital, and a net importer of technology.

The Australian Government, and commerce and industry, like our competitors in the global marketplace for foreign investment and for technology, have worked hard over many years to understand what factors drive foreign investment decisions.

Such analytical work, by government agencies, the private sector, and academic and public policy institutions, has been extensive and is verging on becoming a multinational industry itself.

THE POLICY FRAMEWORK FOR INVESTMENT

The OECD recently published a Policy Framework for Investment (PFI) – a guidebook for encouraging investment in developing countries.

The PFI in many respects deals with much the same terrain as the numerous governmental, academic, private sector and public policy think-tank research into the drivers of foreign direct investment.

That is, it addresses the challenging issue of what a prospective host country has to do to attract and retain foreign direct investment.

However, the PFI differs from much of the other work in one important respect.

Rather than attempting to quantify and establish rankings based on the relative importance of different factors, the PFI sets down a non-prescriptive checklist of issues for national governments looking to attract and retain foreign direct investment.

The OECD quite correctly points out:

> "… there is no single policy instrument to boost inward investment …. easy fixes such as subsidies alone will run aground if, for instance, bureaucracy is too costly."

> "In other words, the most effective way to realise the full potential of investment is to put in place a range of conditions needed to attract and sustain these investments for the long term."

At the same time, it is important to remember there is no single 'one size fits all' approach to attracting and retaining foreign direct investment which works for all countries at all times in all conditions.

The policy mix that works for one developed country may not work for another developed country, which may not work for different developing countries.

What worked a decade ago may not work now, and may well work or not work in the future. What works for a resource-rich/labour-poor country may well not work for a resource-poor/labour-rich country.

That is why the PFI, usefully, addresses policy issues and challenges across a range of core policy areas including competition, corporate and public governance, investment, taxation and international trade.

The core policy areas in turn cover 10 primary domains, excluding the self-evident one of stable macroeconomic conditions, each of which have a clear resonance for the broader investment environment.

The axiomatic nature of stable macroeconomic conditions, and its corollary of transparent and predictable economic policy, means if these foundations are not in place then the other policy settings are unlikely to be effective and/or cannot compensate for shortcomings in the macroeconomic area.

These domains are:

- investment policy;
- investment promotion and facilitation;
- trade policy;
- competition policy;
- taxation policy;
- corporate governance;
- responsible commercial conduct;
- human resources development;
- infrastructure and financial services; and
- public governance.

By way of example on four of these domains:

- on investment policy, the PFI means issues like transparency of laws, regulations and processes, protection of physical property against expropriation and non-discrimination on the basis of nationality or other characteristics;
- on trade policy, it means policy settings which encourage national integration into, and competitiveness within, the global marketplace;
- on tax policy it means policy settings which deliver efficient and competitive taxation systems in their design, substance and administration; and
- on public governance it means focusing on public sector integrity (i.e. effective action to tackle corruption) and regulatory quality – in effect, keeping the grabbing hand of government under control.

Making effective use of the PFI is not about policy makers getting each and every one of the 10 primary domains individually 'right' in all circumstances.

Rather it is about finding the optimal policy mix for the country concerned at its relevant time and place, and its development/growth trajectory.

This means accepting there are policy trade-offs to be made, and these must be informed by a range of factors, including the policy settings applied by competitor nations pursing the same foreign direct investment.

The PFI is useful in this regard, by providing actual and potential host countries with a tool kit to benchmark their policy settings for investment against international accepted practices – and by implication against those of other countries.

It also emphasises self-assessment, in contrast to the conventional peer review or third party pressure mechanisms, such as the various international competitiveness scorecards published each year.

In undertaking objective and rigorous self-evaluations, actual and aspiring host countries for foreign direct investment should clearly identify both sides of the policy balance sheet.

That is, on the one side, the country's achievements and the attractive elements of its policy mix, and on the other its failures and deterrent aspects.

Analysis must also include pragmatic consideration of the policy changes needed to deliver solutions to existing, and potential, problems.

ACCI MODELLING

In 2001, ACCI undertook an extensive research program of econometric modelling looking at the drivers of foreign direct investment.

Our core research question was: *What factors determine a country's appeal as a destination/host for foreign direct investment?*

The study looked at a sample of 45 countries (24 developed and 21 developing).

The former included Australia, Britain, Canada, Japan, Switzerland and the USA while the latter included Brazil, China, India, Russia and Turkey.

We grouped our findings into three categories - the variables of most, intermediate and lower importance.

Our research/modelling showed the factors of greatest importance in raising levels of inward foreign direct investment were:

- foreign investor control;
- cost of capital;
- corporate taxation;
- regional integration;
- protectionism; and
- shareholders rights and responsibilities.

In short, foreign investors want security in their investment from expropriation, internationally competitive taxation systems and open economies which practice liberal, outward looking trade policies.

Investment incentives were of only intermediate importance, suggesting foreign investors will take them if they are offered but are not really attracted by them (or recognise they are sometimes offered as a means of compensating for policy failures elsewhere in the prospective host country).

By contrast, foreign investors attach relatively low importance to factors such as the nature of political system, although no doubt prefer stability to instability.

Our modelling also found foreign investors attached comparatively little importance to environmental issues, although the analysis was undertaken before the current public policy frenzy over climate change issues.

WHERE TO NOW?

Commerce and industry in Australia would very much like to see APEC step up its program of work – and delivered outcomes – on investment facilitation and liberalisation.

ACCI welcomed the release a long time ago of the APEC Non-Binding Investment Principles.

We saw them as a sound first step toward a robust set of Binding Investment Principles. Unfortunately, the second step never came.

Given the divisions within APEC on its agenda (liberalisation vs facilitation) and on its modus operandi (binding commitments vs voluntarism) we have come to accept that treaty-like/-status agreements within APEC are unlikely to emerge in the foreseeable future.

However, this does not foreclose on all of the possibilities for improving policy environments for investment within the APEC region.

APEC could play a role by giving life to the PFI in the Asia Pacific region by taking two concrete steps:

- first by the developed countries members of APEC who are also members of the OECD – say Australia, Japan, New Zealand, South Korea and the USA – undertaking demonstration PFI self-assessments and then reporting the results to an appropriate APEC forum; and
- secondly, each of the APEC/OECD members partnering one or more APEC/non-OECD developing country members to undertake rigorous and transparent PFI self-assessment, again reporting the results to an appropriate APEC forum.

In both cases, rigorous and transparent self-assessment does not mean a self-congratulatory report by the national investment promotion agency full of graphs and quotes.

Rather, it means engaging substantially with domestic and foreign businesses across all benchmarks and accepting criticism as constructive rather than as a lethal wounding.

ACCI would also like to see the development of a second path for multilateral investment liberalisation and facilitation in the form of a General Agreement on Investment within the World Trade Organisation.

The work of the OECD on the PFI and its other relevant instruments such as its Guidelines for Multinational Enterprises and the unrealised Multilateral Agreement on Investment (MAI), could usefully inform this endeavour.

Given the slow progress, and uncertain future, of the current Doha Round, such work is not likely to commence, let alone be completed, any time soon.

However, it should be on the work program for the WTO and the Round which follows Doha.

CONCLUSION

There is no single 'one size fits all' approach to attracting and retaining foreign direct investment.

However, the OECD's Policy Framework for Investment is a good place for many developing countries to start.

ACCI would like to see a new General Agreement on Investment eventually developed under the auspices of the World Trade Organisation.

However given the slow progress on the Doha Round of trade negotiations, ACCI sees merit in APEC countries leading by example and conducting rigorous domestic investment framework assessments.

The countries of our region could usefully demonstrate that they are serious about improving the investment climate for business and continuing the region's strong economic growth well into the coming decade.